

June 21, 2002

D.T.E. 02-40

Investigation by the Department of Telecommunications and Energy on its own Motion into the Provision of Default Service.

ORDER OPENING INVESTIGATION INTO THE PROVISION OF DEFAULT SERVICE

I. INTRODUCTION

"Default service," as the term is used in the Electric Restructuring Act,¹ denotes the provision of electricity to those consumers who do not receive generation service either from an electric distribution company under standard offer service or from a competitive supplier. At the end of the standard offer service transition period in February 2005, the role of default service in the restructured electric industry will increase significantly as it will become the generation service of last resort for all electricity consumers. By its very nature as a generation service of last resort, the manner in which default service is made available to consumers could significantly affect the development of the competitive market. Therefore, the Department of Telecommunications and Energy ("Department") opens this inquiry to investigate all aspects of the manner in which default service is provided to ensure that it is compatible with the development of an efficient competitive market. By opening this investigation now, we can best ensure that the benefits of a competitive market are available to all Massachusetts consumers at the end of the standard offer service transition period.

II. BACKGROUND

A. Introduction

The Electric Restructuring Act, G. L. c. 164, § 1B(d), requires (1) that each distribution company provide default service; (2) that default service be competitively procured; (3) that the default service rate "shall not exceed the average monthly market price of electricity;" and (4) that bids to supply default service "shall include payment options with rates

¹ St. 1997, c. 164.

that remain uniform for periods of up to six months." In 1999, the Department opened an investigation into the pricing and procurement of default service in order to determine the average monthly market price of electricity and to determine how this price should be incorporated in the default service rate.² Pricing and Procurement of Default Service, D.T.E. 99-60 (1999). Issues related to the procurement of default service were also investigated because the manner in which such procurement occurs affects both the price of default service and the retail competitive market in general. Id.

B. Price Components

In Pricing and Procurement of Default Service, D.T.E. 99-60-B at 16-19 (2000), the Department directed the distribution companies to set their default service prices equal to the bid price of the winning default service supplier(s). The Department considered whether the administrative costs incurred by distribution companies in providing default service should be included in default service prices. We stated that the inclusion of these administrative costs would ensure that all costs of providing default service are included in the default service price seen by customers, thus allowing competitive suppliers "a fair and reasonable opportunity to compete for default service customers." Pricing and Procurement of Default Service, D.T.E. 99-60-A at 9-10 (2000). However, the Department rejected the inclusion of administrative costs, concluding that, while the inclusion of these costs in the price of default

² From the date that retail choice was introduced on March 1, 1998, until January 1, 2000, the Department directed distribution companies, in the absence of fully developed markets, to use their standard offer service price as the proxy for the market price for electricity and the basis for their default service price. See Letter to Massachusetts Electric Company Regarding Pricing for Default Service (June 1, 1999).

service sends the right price signal to customers, the benefits of including the relatively small magnitude of the administrative costs would be outweighed by the costs of its inclusion.

D.T.E. 99-60-B at 19. The Department similarly rejected the inclusion in default service prices of costs associated with bad debt, because these costs also would not be significant compared to the bid prices. Id. Finally, the Department rejected the inclusion of an adder for marketing costs incurred by retail providers, stating that it would be inappropriate to include artificial costs for the purpose of spurring competition. D.T.E. 99-60-A at 11.

C. Pricing Options

Default service customers currently have two pricing options from which to choose: (1) a variable price that changes monthly, based on the monthly wholesale price(s) that each distribution company pays to its default service supplier(s); and (2) a fixed price that remains level for six months, calculated as the weighted average of the monthly prices.

D.T.E. 99-60-A at 6-9. In order to ensure that customers pay the full costs of providing the service for the period that it is received, default service customers using the six-month pricing option and who leave default service before the end of the six-month period have their default service costs recalculated using the monthly prices that were in effect during each month that the customer received default service. Id.

D. Procurement

In D.T.E. 99-60-B at 16, the Department directed the distribution companies to competitively procure default service supply for a period ranging from a minimum of six months to a maximum of one year. The Department directed the distribution companies to solicit default service supply proposals with separate bid prices for residential, commercial, and

industrial customers in order to determine whether there are significant cost differences in serving the different customer classes. D.T.E. 99-60-B at 13-14. The Department did not specify the number of default service suppliers that each distribution company could select through its competitive solicitations.

III. SCOPE OF INVESTIGATION

As stated above, the Department's objective in opening this investigation is to ensure that the manner in which default service is provided is compatible with the development of an efficient competitive market in Massachusetts. The Department will evaluate a broad continuum of issues related to the provision of default service in this proceeding. One end of the continuum assumes that distribution companies will continue to serve as the providers of last resort for generation service in the restructured electric industry and that we will rely fully on the marketplace to motivate default service customers to switch to competitive supply. The other end of the continuum assumes that the development of a robust competitive market requires that default service be provided by the competitive marketplace and that distribution companies will no longer serve as providers of last resort.

In D.T.E. 99-60-A at 4, the Department stated that default service should function as a basic service that provides consumers with the appropriate incentives to turn to the competitive market for more sophisticated or advantageous service offerings. Customer migration data compiled by the Commonwealth of Massachusetts Division of Energy Resources ("DOER") illustrate the extent to which competition has developed in the restructured electric industry in

Massachusetts.³ The data suggest that a competitive market is developing to serve both large and medium commercial and industrial (“C&I”) customers, as evidenced both by the percentage of electricity consumed by these consumer classes that is provided by the competitive market,⁴ and by a comparison of consumption that is competitively provided versus consumption that is provided through default service.⁵ Conversely, the customer migration data indicate that an active competitive market has not yet developed for small C&I⁶ and residential customers.⁷ While there are certainly other contributing factors (in particular, below-market standard offer service prices), the Department must identify those features of default service that may impede or deter consumers’ resort to the competitive market. Therefore, as part of this investigation, the Department will evaluate our default service policies in the following three

³ Information on customer migration is available on DOER’s website at <http://www.state.ma.us/doer> (“DOER Website”). April 2002 is the most recent month for which customer migration data are available.

⁴ As of April 2002, approximately 42 percent of the electricity consumed by large C&I customers was provided by the competitive market, an increase of almost 100 percent over the amount competitively provided as of September 2001. For medium C&I customers, approximately 16 percent of consumption was provided competitively as of April 2002, an increase of almost 500 percent over the amount that was competitively provided as of September 2001 (see DOER Website).

⁵ In April 2002, almost four times as much electricity was provided by the competitive market as was provided by default service for large C&I customers. For medium C&I customers, the amount of electricity provided by the competitive market was slightly less than was provided by default service (see DOER Website).

⁶ For small C&I customers, approximately seven percent of consumption was provided competitively as of April 2002. Approximately four times as much consumption was provided by default service (see DOER Website).

⁷ For residential customers, less than one percent of consumption was competitively provided, as compared to 23 percent provided through default service (see DOER Website).

areas: (1) the price components to be included in default service rates, including administrative and bad debt costs and the effects of locational marginal pricing; (2) default service pricing options; and (3) procurement schedules and strategies.

The Department will also use this proceeding to look more comprehensively at the issue of how default service may be provided in the context of a competitive electric industry. For example, we will continue the investigation begun in D.T.E. 01-54 into the appropriate role of distribution companies in moving their customers towards competitive supply. We will also consider whether distribution companies should serve as the default service providers of last resort or whether this function can and should be provided by other entities.

The Department recognizes that we may not currently have the statutory authority to implement certain types of initiatives in these areas. However, if appropriate, the Department may use the results of this investigation to develop a report to the General Court on the provision of default service where necessary statutory changes can be considered.

III. PUBLIC PARTICIPATION

The Department will conduct a public hearing on the provision of default service at our offices at 10:00 a.m. on July 23, 2002, and may schedule additional public hearings in other parts of the Commonwealth. We invite all interested persons to discuss these issues at technical session to be held immediately after the initial public hearing. The Department also welcomes written comment on these issues. Initial comments should be filed by August 1, 2002. Supplemental comments should be filed by September 3, 2002. All comments exceeding 20 pages in length must contain an executive summary. One original and ten copies of all comments should be filed with Mary Cottrell, Secretary, Department of

Telecommunications and Energy, One South Station - 2nd Floor, Boston, Massachusetts 02110.

All written comments also should be submitted to the Department in electronic format.⁸ After the public hearing, technical conference, and review of the comments received, the Department will determine what further proceedings may be appropriate.

IV. ORDER

Accordingly, the Department

VOTES: To open an investigation into the provision of default service; and it is

ORDERED: That within seven days of the date of this Order, the Secretary of the Department shall publish notice of this investigation in a statewide newspaper of daily circulation within the Commonwealth; and it is

⁸ Electronic submissions should be made using one of the following methods: (1) by e-mail attachment to dte.efiling@state.ma.us and or (2) on a 3.5" disk, IBM-compatible format. The text of the e-mail or the disk label must specify (1) the docket number of the proceeding (D.T.E. 02-40), (2) name of the person or company submitting the filing, and (3) a brief descriptive title of the document. The electronic filing should also include the name, title and phone number of a person to contact in the event of questions about the filing. Text responses should be written in either Word Perfect (naming the document with a ".wpd" suffix), in Microsoft Word (naming the document with a ".doc" suffix), or as an Adobe PDF file (naming the document with a ".pdf" suffix). Data or spreadsheet responses should be compatible with Microsoft Excel. All written pleadings or comments submitted in electronic format will be posted on the Department's website, <http://www.mass.gov/dpu>.

FURTHER ORDERED: That the Secretary of the Department shall serve a copy of this Order by mail on all persons that have asked to be placed on a general notification list pursuant to 220 C.M.R. § 2.09.

By Order of the Department,

Paul B. Vasington, Chairman

James Connelly, Commissioner

W. Robert Keating, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner